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In The
Supreme Court of the United States

COMMONWEALTH OF PUERTO RICO, *et al.*,

Petitioners,

v.

ARECIBO COMMUNITY HEALTH CARE, INC., *et al.*,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The First Circuit

REPLY BRIEF OF PETITIONERS COMMONWEALTH OF PUERTO RICO

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Reply Brief Of Petitioners

In its Petition for Certiorari, the Commonwealth of Puerto Rico identified a clear conflict among the circuits as to the fundamental constitutional question of the applicable standard for determining the scope of waiver that arises upon the filing of suit by a state in federal bankruptcy court.[1] If the waiver is narrow – as two courts of appeal have found and the court below initially held – it would almost certainly follow that the "deemed waiver" language in Section 106(b) of the Bankruptcy Code is unconstitutional under the views announced in *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666 (1999). As the Petition further shows, this conflict, and its effect on the validity of Section 106(b), is of critical concern to the states. They need to know, clearly and unambiguously, whether they become the equivalent of a private litigant simply by filing a claim, so that they can gauge the risks they face if they choose to participate in a bankruptcy to protect the rights of their citizens.

In their Opposition, Respondents suggest that there is no conflict between the circuits in that none have yet specifically held that *College Savings* renders Section 106(b) unconstitutional. They further assert that the

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[1] The First Circuit acknowledged that Puerto Rico should be treated like a state for purposes of applying the Eleventh Amendment. App. p. 4, fn. 3. While there are some differences between the treatment of Puerto Rico and the 50 states, the court below did not rely on those differences in deciding this case. The Opposition notes, but does not strongly rely on, this issue as a reason for denial of certiorari. The Commonwealth urges the Court to grant certiorari because the question it presents is of such significance that it deserves immediate attention – as attested to by the 29 states and the Territory of the Virgin Islands that signed the amicus brief, asking the Court to hear the matter now.

decision in *Lapides v. Board of Regents of Univ. System of Ga.*, 535 U.S. ___, 122 S.Ct. 1640, 2002 WL 970637 (May 13, 2002), supports the merit of the First Circuit's position. Their first argument is a red herring, which ignores the split actually identified by the Commonwealth; and their second argument underscores the importance of taking this case in order to clarify the dicta contained in the *Lapides* opinion.

I. The Conflict Among the Courts of Appeal is Direct and Genuine, and Must be Resolved in Order to Determine Whether Section 106(b) of the Bankruptcy Code is Constitutional

As shown in the Petition, there is a clear circuit split regarding whether, as a constitutional matter, a state broadly waives its sovereign immunity and becomes the equivalent of a private litigant when it files suit in bankruptcy court, so as to allow affirmative monetary awards to be entered against it. The circuit courts that have upheld Section 106(b) have relied primarily on their answer to that constitutional question. Two other courts of appeal have answered that fundamental question differently and their rationale would appear to doom Section 106(b). Only this Court can resolve the constitutional conflict and provide the framework for resolving the validity of the statute.

This Court held in *United States v. U.S. Fidelity & Guaranty Co.*, 309 U.S. 506, 60 S.Ct. 653, 84 L.Ed. 894 (1940), *United States v. Shaw*, 309 U.S. 495, 60 S.Ct. 659, 84 L.Ed. 888 (1940), and *Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe of Oklahoma*, 498 U.S. 505, 111 S.Ct. 905, 112 L.Ed.2d 1112 (1991), discussed at pp. 9-12 of the Petition, that in cases involving the United States and Indian tribes, filing a claim in either federal or state court is not a general waiver of immunity

and does not allow relief to be entered that exceeds in amount or that differs in kind from that sought by the entity that filed suit. The lower federal courts, as shown at pp. 11-12 of the Petition, have readily applied the same standard to states in nonbankruptcy cases.[2] In bankruptcy, however, as shown in the Petition, pp.12-17, courts have asserted differing views.

The Sixth and Seventh Circuits, operating under the constitutional standard that applied before statutory abrogation language was included in the Bankruptcy Code, held that the same standard applied to states as to other governmental entities. Under that view, Section 106(b) plainly is a substantial expansion of the common law in that it allows for affirmative relief and, after this Court's decision in *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996), and *College Savings*, appears to be presumptively invalid.

On the other hand, the First Circuit, and other circuit courts taking similar positions since the statutory changes, read this Court's decision in *Gardner v. New Jersey*, 329 U.S. 565 (1947), as finding a broad constitutional waiver by a state that files a claim in bankruptcy

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[2] This is so because no action is being taken *against* a state when it files a federal suit or a proof of claim. Nor, as stated in *Gardner v. New Jersey*, 329 U.S. 565 (1947), has any action been taken against the state merely because a defendant defends itself by denying the state's allegations. Since recoupment is also viewed as a defense, there is no more need to show consent by the government to assert those types of claims than for any other defense. However, since such claims may be heard precisely because they are *defenses*, they have no basis except to defeat the government's claim. If additional recovery, in the nature of affirmative or different relief, is to be allowed after the government's claim is denied, this must be based upon some independent basis of jurisdiction or by a showing of actual consent by the state to litigation of the additional relief. See cases cited in Petition, pp. 11-12, fn. 4 and 5.

court.[3] Having concluded that the common law already finds a general waiver of immunity, such that states become the functional equivalent of private litigants, they assume the constitutionality of Section 106(b) to be a given. Indeed, under their view, Section 106(b) does not approach the limits of what Congress could have stated that states have acceded to upon the filing of a proof of claim. Thus, Section 106(b) is either wholly unnecessary or could even be seen as *narrowing* the constitutional standard. *In re Straight*, 143 F.3d 1387, 1390 (10th Cir.), *cert. denied*, 525 U.S. 982 (1998).

In short, there are two diametrically opposed views of the background constitutional rule regarding waivers by states of their immunity. In the Sixth and Seventh Circuits, some additional power must be found in order to validate Section 106(b). If Congress may require States to agree to be sued for affirmative relief in order to engage in the lawful activity of filing claims in a bankruptcy case, these Circuits would require some basis be shown beyond the constitutional implications arising from the filing of a suit. The First Circuit and its adherents, on the other hand, see no need to identify any further source of Congressional power and would find no immunity-related limits on what Congress may do. No other authority is needed because the filing itself evidences consent by the state to being treated as a private litigant and Section 106(b) is obviously valid. The conflict between those two views is real and critical and requires resolution by this Court now.[4]

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[3] The First Circuit read *Gardner* expansively and added that it took *College Savings* as expanding upon even that holding. App. p. 13.

[4] Prior to *Seminole* and *College Savings*, and especially after *Pennsylvania v. Union Gas*, 491 U.S. 1 (1989), the constitutional issue may have seemed irrelevant. If Congress could abrogate state immunity as broadly as it chose, so long as it did so clearly and unmistakably, the only issue was one of statutory construction. After, this Court held in

(Continued on following page)

II. If the Conflict is Not Resolved, States in at Least Six Circuits Will Risk Entry of Affirmative Relief if They Participate in a Federal Court Proceeding

If, as the First Circuit opinion suggests, there is a broad waiver of immunity from filing a claim, then Congress may obviously allow mandatory counterclaims to be filed against the state even if this results in the state being exposed to vastly larger claims than those that it filed. Indeed, if the filing of a claim inherently strips the state of *all* immunity, there is no obvious limit to the conditions that can be placed upon the state once it enters federal court. *College Savings* rejected the notion that Congress could require a state to waive its immunity in order to engage in lawful activity. But, if filing a claim inherently waives *all* immunity, then Congress need demand no further waiver in order to allow affirmative relief against states. The only condition would be that Congress must state its intention with the necessary clarity.

This broad waiver rule forces states into a "Hobson's choice" – file a claim and be subject to unlimited liability on even unrelated matters – or forego entirely the right to seek compensation for their citizens. Moreover, they cannot avoid the problem by limiting themselves to proceeding only

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Hoffman v. Conn. Dept. of Income Maint., 492 U.S. 96 (1989), and *Nordic Village v. U.S.*, 503 U.S. 30 (1992), that Congress had failed to use the requisite clarity in then-Section 106(c), the statute was amended in 1994. After *Seminole*, the circuit courts agreed that the abrogation language in new Section 106(a) was unconstitutional, but debated whether the "deemed" waiver in Sections 106(b) and (c) was equivalent to abrogation. After *College Savings* held that such language was the "same side of the same coin" as abrogation, 527 U.S. at 683, the courts have returned to the earlier debate over whether there is a separate constitutionally-based waiver that arises upon the filing of a claim.

in state courts. If a bankruptcy is filed, the state may collect money it is owed for taxes, for child support, for consumer protection, and the like, only by entering the federal proceeding. The same requirements apply to the United States government and Indian tribes, but they do not face the threat of unlimited, affirmative relief on counterclaims.[5] Moreover, while thus far circuit courts have adopted this broad waiver analysis only in the bankruptcy context, it is not based on anything unique to bankruptcy. If this Court upholds the broad standard sought by Respondents, then parties are likely to argue that the same result applies outside of bankruptcy. Since some actions, like those under CERCLA, can only be brought in federal court, this principle is likely to result in a far wider impact on states than merely in bankruptcy.

The Commonwealth respectfully suggests that issues dealing with state immunity, particularly in bankruptcy, cry out for this Court's attention without undue delay. In *Puerto Rico Aqueduct and Sewer Authority v. Metcalf & Eddy, Inc.*, 506 U.S. 139 (1993), this Court concluded that the importance of sovereign immunity issues to the Commonwealth warranted the grant of a broad right of interlocutory appeal. Similar considerations suggest that this Court should not leave the law in continued confusion and the states and lower courts without guidance as to the potential liability the states face when they enter federal court.

Indeed, while the Court has addressed ramifications of its pivotal decision in *Seminole* in many areas, it has not yet taken a case applying those principles to bankruptcy

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[5] This unlimited liability contrasts dramatically with Spending Clause cases which require some "nexus" between the benefit proffered and the demanded waiver of immunity, and where it is recognized that the *quid pro quo* might be so burdensome as to become unlawfully coercive. *College Savings*, 527 U.S. at 687. No such limit exists here.

matters. As a result, despite the recognition in *Seminole* by both the majority and the dissent, that its holding would apply to bankruptcy (517 U.S. at 1132, fn. 16, and 517 U.S. at 1134, fn. 1), some lower courts have remained unconvinced that its holding applies at all in the bankruptcy arena. See, e.g., *In re Hood,* 262 B.R. 412 (6th Cir. BAP 2001). Granting certiorari would further allow the Court to affirm that bankruptcy, like other Article I powers, is governed by *Seminole*.

III. *Lapides* Heightens the Need For the Court to Review this Case

In *Lapides v. Board of Regents of Univ. System of Ga.*, 535 U.S. ___, 122 S.Ct. 1640, 2002 WL 970637 (May 13, 2002), the Court held that the state's agreement to the removal of a lawsuit to federal court waived its Eleventh Amendment immunity. That suit, though, involved only the issue of whether the state had consented to the federal court hearing the precise claims that had been filed against it in state court. The case did not involve the scope of a state's waiver of immunity from new counterclaims filed by a defendant. In its brief in *Lapides*, however, the state of Georgia briefly cited the *Shaw, U.S. Fidelity & Guaranty,* and *Potawatomi* line of cases to illustrate the stringent nature of the review this Court has used in determining if a particular action of a sovereign shows consent to suit. In distinguishing those cases, this Court described the state's brief as pointing

> to cases in which this Court has permitted *the United States* to enter into a case voluntarily without giving up immunity or to assert immunity despite a previous effort to waive.... Those cases, however, do not involve the Eleventh Amendment – a specific text with a history that focuses upon the State's sovereignty vis-a-vis the Federal

> Government. And each case involves special circumstances not at issue here, for example, an effort by a sovereign (i.e., the United States) to seek the protection of its own courts (i.e., the federal courts), or an effort to protect an Indian tribe. Slip op. at 9; 2002 WL 970637, p. 5 (emphasis in original).

Respondents read that language to suggest that (1) there is a difference between the true "sovereign immunity" of the United States in its own courts and that of the states in another sovereign's courts, and (2) Indian tribes are to be protected by granting them greater immunity than that held by the states. Br. in Opp. 13. As such, they argue that the cases relied upon by the Commonwealth cannot be used to show that the common-law standard set out therein for the United States and Indian tribes is applicable to the states.

Both of those propositions, however, would mark a radical departure from this Court's existing treatment of sovereign immunity. To read *Lapides* as suggested would require one to assume that this Court had, *sub silentio*, overruled decades of case law that treated the immunities of various governmental entities as largely interchangeable. In *College Savings, supra*, 527 U.S. at 682, for instance, this Court stated that "in the context of federal sovereign immunity – obviously the closest analogy to the present case – it is well established that waivers are not implied. . . . We see no reason why the rule should be different with respect to state sovereign immunity." Similarly, in *California v. Deep Sea Research, Inc.*, 523 U.S. 491, 506-07 (1998), this Court, in making its decision to *deny* immunity to the state noted that "[i]n considering whether the Eleventh Amendment applies . . . , this Court's decisions in cases involving the sovereign immunity of the Federal Government . . . provide guidance, for this Court has recognized a correlation between sovereign immunity principles applicable to States and the Federal Government." 523 U.S. at 506-07.

This Court has relied in many other decisions on similarities between the treatment of various sovereign immunities in deciding how particular cases should be decided and has cited cases involving the different immunities interchangeably. A limited sample would include *Tindal v. Wesley*, 167 U.S. 204, 213 (1897) ("it cannot be doubted that the question whether a . . . suit is against the State . . . must depend upon the same principles that determine whether a . . . suit is against the United States"); *Malone v. Baldwin*, 369 U.S. 643, 646 n.6 (1962) (discusses *United States v. Lee*, 106 U.S. 196 (1882) and cites both state and federal cases on state immunity issue); *Monaco v. Mississippi*, 292 U.S. 313, 320-21 (1934) (relies on fact that United States retained sovereign immunity, despite wording of Article III, as reason to find that states also retain immunity from suit); *Pennhurst State School & Hospital v. Halderman*, 465 U.S. 89 (1984) (applied *Dugan v. Rank*, 372 U.S. 609, 620 (1963), a federal case, to define when suit is "against" the state; dissent relied extensively on *federal* immunity cases to argue that *state* officers could be sued); and *Blatchford v. Native Village of Noatak and Circle Village*, 501 U.S. 775 (1991) (related rights of tribes to rights of states).

Under that well-established line of cases, the Commonwealth is entitled to the same degree of protection as the United States – and, as *Blatchford* makes clear – surely as much as Indian tribes. If so, then it is critically important that this Court clarify that the distinctions drawn in the *Lapides* case were not meant to overrule this longstanding correlation. If, on the other hand, this Court actually intended to establish a new rule that sets the various forms of immunity on a sliding scale, with states' Eleventh Amendment immunity at the bottom of that scale, then it is vitally important for the states to know this. The legislative branch is required to speak with the

utmost clarity; it is equally important for this Court to clearly define both the limits of the state's immunity and the rationale for allowing any infringement on that immunity.[6]

Conclusion

Accordingly, for the reasons stated above, the Commonwealth respectfully urges this Court to grant its petition for certiorari and accept this case in order to clarify the scope of the waiver that arises from the filing of an action in federal bankruptcy court.

Respectfully submitted,

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[6] The states' uncertainty as to the implications of *Lapides* is exacerbated by its concern that the distinctions drawn in the opinion seem to be at odds with the facts of those cases. Only *U.S. F&G* involved the immunity of the United States in its own courts, while the other two, like the case here involved a sovereign in a different court. Nor does it appear that protection of tribal interests was a significant factor in *Potawatomi*. These discrepancies leave further ambiguity in how the opinion should be interpreted.